IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION TWO

DESERT HERITAGE LIMITED PARTNERSHIP, an Arizona limited partnership, Plaintiff/Appellant, v. CITY OF TUCSON, a political subdivision, Defendant/Appellee.	2 CA-CV 2007-0123 DEPARTMENT B MEMORANDUM DECISION Not for Publication Rule 28, Rules of Civil Appellate Procedure

APPEAL FROM THE SUPERIOR COURT OF PIMA COUNTY

Cause No. C20063789

Honorable John F. Kelly, Judge

AFFIRMED IN PART;
REVERSED AND REMANDED IN PART

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H O W A R D, Presiding Judge.

¶1 Appellant Desert Heritage Limited Partnership appeals from the trial court's grant of appellee City of Tucson's motion for summary judgment on Desert Heritage's claim that the City breached a lease by cancelling it and of the City's motion to dismiss Desert Heritage's claims of unpaid rent and unamortized tenant improvements. Because issues of fact preclude summary judgment on the cancellation claim, we reverse that ruling, but affirm the dismissal of the unpaid rent claim.

Factual and Procedural Background

¶2 The basic factual background is undisputed. The City leased office space in a building owned by Desert Heritage. Although there were multiple leases for different spaces, the lease at the center of this controversy involved space used by the City's Human Resources Department ("HR lease" or "the lease"). An addendum to the lease included a cancellation clause providing circumstances under which the City could cancel the lease before the end of its term, March 31, 2008. The clause reads:

> In the event that the Mayor and Council of the City of Tucson shall not appropriate sufficient funds for the payment of the rent (as set forth by the Lease) in the adopted budget for the fiscal years subsequent to 2000 – 2001, then [the City] shall have the right annually upon the anniversary of its lease term, with 90 days prior written notice to [Desert Heritage], to cancel the lease. In such an event, [the City] will immediately pay to [Desert Heritage] the total sum of any unamortized costs for tenants improvements to the demised premises.

In December 2005, the Mayor and Council adopted a resolution directing the City Manager to "eliminate funding from the annual City budget for outside rental of office space for the

City of Tucson Department of Human Resources for fiscal Year 2006–2007." One week later, the City notified Desert Heritage that it would exercise the cancellation clause in the lease, effective April 1, 2006.

¶3 Desert Heritage then sued the City, claiming it had breached the lease by failing to comply with the cancellation clause and by violating the covenant of good faith and fair dealing in exercising that clause. It also sought damages for unpaid rent and unamortized tenant improvement costs. The City moved for partial summary judgment, contending that it had complied with the cancellation clause and that it did not violate the covenant of good faith and fair dealing. The trial court granted that motion.

¶4 Subsequently, after our supreme court issued its opinion in *Deer Valley Unified School District No. 97 v. Houser*, 214 Ariz. 293, 152 P.3d 490 (2007), the City moved to dismiss the unpaid rent and unamortized tenant improvement claims for failure to comply with A.R.S. § 12-821.01, the notice-of-claim statute. The trial court granted that motion and entered final judgment in favor of the City. Desert Heritage then appealed.

Compliance with the Cancellation Clause

¶5 Desert Heritage first argues the trial court erred by granting summary judgment against it on its claim that the City breached the lease by failing to properly comply with the cancellation clause. We review the grant of summary judgment de novo and view the facts in the light most favorable to the opposing party. *Liberty Mut. Fire Ins. Co. v. Mandile*, 192 Ariz. 216, 222, 963 P.2d 295, 301 (App. 1997). "[W]e reverse the summary judgment

if our review reveals that reasonable inferences concerning material facts could be resolved in favor of the opposing party." *Id.*

¶6 Our goal in interpreting a contract is to determine the parties' intent and give effect to the contract as a whole. *Potter v. U.S. Specialty Ins. Co.*, 209 Ariz. 122, ¶ 7, 98 P.3d 557, 559 (App. 2004). We view the language of the contract in the context of the surrounding circumstances. *Id.* We will enforce a valid contract even if the result is harsh. *Freedman v. Cont'l Serv. Corp.*, 127 Ariz. 540, 545, 622 P.2d 487, 492 (App. 1980).

¶7 Desert Heritage contends the cancellation clause requires that the Mayor and Council fail to appropriate funds and asserts the process of cancellation and relocation had begun before the Mayor and Council were even involved. But the cancellation clause does not require that the idea of cancellation originate with the Mayor and Council. It simply requires that they fail to appropriate funds and allows the City to cancel the lease on an anniversary date so long as it provides Desert Heritage with ninety days' notice. It did provide such notice. The trial court did not err in finding that the City had complied with the express terms of the cancellation clause.

¶8 Desert Heritage also contends that the City failed to comply with the cancellation clause because the December 2005 resolution removed funds from the budget that did not take effect until July 2006. In considering this issue, we view the contract in the context of its surrounding circumstances. *See Potter*, 209 Ariz. 122, ¶ 7, 98 P.3d at 559. The lease has an anniversary date of March 31 and required notice of cancellation ninety

days prior to that date. If the City's budget that went into effect in July did not provide funds for the lease, the City had to be able to cancel the lease before the March 31 anniversary date. Otherwise, it would have had the lease obligation but not the funds to pay for it. If the actual budget adopted later provided funds, the City would have breached the lease by cancelling. We must reject Desert Heritage's interpretation because it would render the cancellation clause impossible to effectively exercise. *See Scholten v. Blackhawk Partners*, 184 Ariz. 326, 329, 909 P.2d 393, 396 (App. 1995) (court must construe contract "to give effect to all its provisions and to prevent any of the provisions from being rendered meaningless").

¶9 Finally, Desert Heritage contends that the only valid reason for cancellation under the clause is a lack of sufficient funds to pay for the lease. But the cancellation clause does not limit the reasons for cancellation to a lack of funds. Instead, the decision to "appropriate" funds is a discretionary, legislative act. Therefore, this argument also fails.

¶10 Even assuming the City's cancellation was "self-serving," as Desert Heritage argues, the trial court correctly determined that the City properly had complied with the express terms of the cancellation clause. And, therefore, the City was entitled to summary judgment on that portion of the cancellation claim.

Covenant of Good Faith and Fair Dealing

¶11 Desert Heritage next argues the trial court erred by determining that Desert Heritage had not raised a genuine issue of material fact concerning the City's alleged breach

of the lease's implied covenant of good faith and fair dealing. Again our review is de novo. *Liberty Mut. Fire Ins. Co.*, 192 Ariz. at 222, 963 P.2d at 301.

¶12 The covenant of good faith and fair dealing is implied in every contract. *Bike Fashion Corp. v. Kramer*, 202 Ariz. 420, ¶ 13, 46 P.3d 431, 434 (App. 2002). "A party may breach an express covenant of the contract without breaching the implied covenant of good faith and fair dealing." *Wells Fargo Bank v. Ariz. Laborers, Teamsters & Cement Masons Local No. 395 Pension Trust Fund*, 201 Ariz. 474, ¶ 64, 38 P.3d 12, 29 (2002). "Conversely, because a party may be injured when the other party to a contract manipulates bargaining power to its own advantage, a party may nevertheless breach its duty of good faith without actually breaching an express covenant in the contract." *Id.*

¶13 It follows from this that "'[i]nstances inevitably arise where one party exercises discretion retained or unforeclosed under a contract in such a way as to deny the other a reasonably expected benefit of the bargain.'" *Bike Fashion Corp.*, 202 Ariz. 420, ¶ 14, 46 P.3d at 435, *quoting Wells Fargo Bank*, 201 Ariz. 474, ¶ 66, 38 P.3d at 30 (alteration in *Bike Fashion Corp.*).

> Thus, Arizona law recognizes that a party can breach the implied covenant of good faith and fair dealing both by exercising express discretion in a way inconsistent with a party's reasonable expectations and by acting in ways not expressly excluded by the contract's terms but which nevertheless bear adversely on the party's reasonably expected benefits of the bargain.

Id.

¶14 In *Wells Fargo Bank*, the court quoted Professor Steven J. Burton's explanation of the duty of good faith:

> "'The good faith performance doctrine may be said to permit the exercise of discretion for any purpose—including ordinary business purposes—reasonably within the contemplation of the parties. A contract thus would be breached by a failure to perform in good faith if a party uses its discretion for a reason outside the contemplated range—a reason beyond the risks assumed by the party claiming a breach.'"

201 Ariz. 474, ¶ 66, 38 P.3d at 30, *quoting Sw. Sav. & Loan Ass'n v. SunAmp Sys., Inc.*, 172 Ariz. 553, 558-59, 838 P.2d 1314, 1319-20 (App. 1992) (footnotes omitted in *Sw. Sav. & Loan*), *quoting* Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 385-86 (1980). The court further observed:

> Burton's recitation fully comports with RESTATEMENT (SECOND) OF CONTRACTS § 205 cmt. a (1981), which states, "Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party." Consistent with Burton and the RESTATEMENT, this court has held in a variety of contexts that a contracting party may not exercise a retained contractual power in bad faith. *See Rawlings [v. Apodaca*, 151 Ariz. 149,] 153-157, 726 P.2d [565,] 569-73 [(1986)] (power to adjust claims in an insurance contract); *Wagenseller [v. Scottsdale Memorial Hosp.*, 147 Ariz. 370,] 385-86, 710 P.2d [1025,] 1040-41 [(1985)] (power to fire employee at will for a bad cause).

Wells Fargo Bank, 201 Ariz. 474, ¶ 66, 38 P.3d at 30. Whether a party's actions constitute a breach of the covenant of good faith and fair dealing is a question of fact. *See id.* ¶¶ 69-70.

¶15 Desert Heritage produced evidence of continuous conflict between it and representatives of the City that had been ongoing before the City exercised the cancellation clause. This included evidence that the City had offered to remain at Desert Heritage's building if Desert Heritage dropped its claim for unpaid rent. Desert Heritage also claimed that, when the City was unable to obtain the concessions it wanted concerning the lease during settlement negotiations, the City decided to exercise the cancellation clause. A jury could determine that the City's alleged use of the cancellation clause to force Desert Heritage to make other concessions regarding the lease was """outside the contemplated range—a reason beyond the risks assumed by the party claiming a breach."""" *Wells Fargo Bank*, 201 Ariz. 474, ¶ 66, 38 P.3d at 30, *quoting Sw. Sav. & Loan*, 172 Ariz. at 558-59, 838 P.2d at 1319-20, *quoting* Burton, *supra*, at 385-86.

¶16 The City claims that it cancelled the lease to reduce expenses and to increase efficiency. But Desert Heritage produced evidence that the City had another motivation and therefore has raised a genuine issue of material fact. Furthermore, based on the limited arguments and evidence presented so far, a jury reasonably could conclude that these goals should have been considered by the City before it entered the lease and, accordingly, were outside the contemplated range. Conversely, a jury could conclude these reasons were not outside the contemplated range. Therefore, even if the jury finds that the City was motivated by cost savings and efficiency, an issue of fact exists at this point in time with regard to

whether those motivations constitute bad faith. Accordingly, we conclude the trial court erred by granting summary judgment on this portion of the claim.

¶17 The City, however, relies on *Southwest Savings & Loan* for the proposition that "'[a]cts in accord with the terms of one's contract cannot *without more* be equated with bad faith.'" *Sw. Sav. & Loan*, 172 Ariz. at 558, 838 P.2d at 1319 (emphasis in *Sw. Sav. & Loan*), *quoting Balfour, Guthrie & Co. v. Gourmet Farms*, 166 Cal. Rptr. 422, 427-28 (Ct. App. 1980). We agree with that statement of the law. But here Desert Heritage produced some evidence from which a reasonable jury could conclude the City had acted in bad faith. If the jury determines that the City acted in bad faith as outlined above, the cancellation was not an act in accord with the terms of the contract, *without more.*

¶18 Because we have concluded an issue of fact exists as to whether the City breached the covenant of good faith and fair dealing by cancelling the lease, we need not address Desert Heritage's argument that, even if cancellation was proper, the City could not cancel the lease until March 2007. Additionally, Desert Heritage's claim for unamortized tenant improvements may become moot, and we will not, therefore, address whether the trial court properly dismissed the claim.

Sufficiency of the Notice of Claim

¶19 Desert Heritage next argues the trial court erred by dismissing its claim for unpaid rent under two different leases based on A.R.S. § 12-821.01, the notice-of-claim

statute.[1] The relevant facts are undisputed and we review issues of statutory interpretation de novo. *See Harris v. Cochise Health Sys.*, 215 Ariz. 344, ¶ 24, 160 P.3d 223, 230 (App. 2007).

¶20 Section 12-821.01(A) requires that anyone with a claim against a public entity or employee file a claim including, among other information, "a specific amount for which the claim can be settled and the facts supporting that amount." The purpose of the claim statute is to """allow the public entity to investigate and assess liability, . . . permit the possibility of settlement prior to litigation, and . . . assist the public entity in financial planning and budgeting."""" *Deer Valley Unified Sch. Dist.*, 214 Ariz. 293, ¶ 6, 152 P.3d at 492 (alteration in *Deer Valley Unified Sch. Dist.*), *quoting Falcon ex rel. Sandoval v. Maricopa County*, 213 Ariz. 525, ¶ 9, 144 P.3d 1254, 1256 (2006), *quoting Martineau v. Maricopa County*, 207 Ariz. 332, ¶ 19, 86 P.3d 912, 915-16 (App. 2004).

> The attendant statutory obligation that claimants present "facts supporting that amount" requires that claimants explain the amounts identified in the claim by providing the government entity with a factual foundation to permit the entity to evaluate the amount claimed. This latter requirement ensures that claimants will not demand unfounded amounts that constitute "quick unrealistic exaggerated demands."

[1]Although styled a "motion to dismiss," the City's motion was in effect a motion for summary judgment because it was filed well after the City's answer and included information outside the pleadings. *See* Ariz. R. Civ. P. 12(b). But because the facts here are undisputed, this distinction is unimportant in this case.

Deer Valley Unified Sch. Dist., 214 Ariz. 293, ¶ 9, 152 P.3d at 493, *quoting Hollingsworth v. City of Phoenix*, 164 Ariz. 462, 466, 793 P.2d 1129, 1133 (App. 1990).

¶21 Desert Heritage's claim stated that the case could be settled for $100,000 and a confirmation that the City would not terminate the HR lease. It provided that the alleged debt consisted of "rent and charges related to (1) the vacated office (commonly referred to as the Tucson-Mexico Project office and later as the Tucson Benefits office), and (2) the vacated office space which had been used by the Human Resources Department." In contrast to the notice of claim, in its statement of facts in response to the City's motion to dismiss, Desert Heritage explained that the charges stemmed from a combination of the City's interpretation of the consumer price index adjustor in the HR lease and the City's failure to pay for space it was not using under the Tucson Benefits office lease.

¶22 Desert Heritage's notice of claim failed to mention the consumer price index dispute or the vacant space dispute later detailed in the statement of facts. It merely provided that the total amount of "rent and charges" due was "nearing $100,000" and did not explain what "charges" Desert Heritage was seeking. Furthermore, the claim failed to list what months were involved and, despite the claim involving two separate leases, it did not describe what amounts were attributable to which leases. This claim failed to provide the City any way to evaluate the merits of the claim. We conclude the claim failed to meet § 12-821.01's requirement of a statement of facts supporting the amount demanded.

¶23 Desert Heritage, however, relies on three cases to support its position that its claim was sufficient: *Hollingsworth*; *Dassinger v. Oden*, 124 Ariz. 551, 606 P.2d 41 (App. 1979); and *State v. Brooks*, 23 Ariz. App. 463, 534 P.2d 271 (1975). But these cases precede the enactment of the present claim statute and the requirement of a statement of facts supporting the amount demanded. *See* 1984 Ariz. Sess. Laws, ch. 285, § 5 (former notice-of-claim statute, then A.R.S. § 12-821, which did not require statement of facts supporting amount demanded); *see also Deer Valley Unified Sch. Dist.*, 214 Ariz. 293, ¶ 19, 152 P.3d at 495 (in enacting current version of § 12-821.01, legislature "statutorily defined for the first time the information needed to comprise a claim"). Accordingly, they cannot support Desert Heritage's position.

¶24 Desert Heritage then complains that the City knew what the difference was between the rent provided for in the leases and what it had paid. It also contends the City was well aware of its position. But "[a]ctual notice and substantial compliance do not excuse failure to comply with the statutory requirements of A.R.S. § 12-821.01(A)." *Falcon*, 213 Ariz. 525, ¶ 10, 144 P.3d at 1256. Nor does the statute require that the City ask for additional facts, as Desert Heritage suggests. It requires Desert Heritage to provide the information in the first instance.

Conclusion

¶25 For the foregoing reasons, we affirm the summary judgment with respect to Desert Heritage's claim that the City did not comply with the terms of the cancellation

clause. We also affirm the dismissal of Desert Heritage's unpaid rent claim. But we reverse the summary judgment with respect to Desert Heritage's claim that the City violated the covenant of good faith and fair dealing when it cancelled the lease. We remand the case for proceedings consistent with this decision. In our discretion, we decline both parties' requests for attorney fees on appeal, without prejudice to the prevailing party requesting attorney fees, at the conclusion of the case.

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JOSEPH W. HOWARD, Judge

CONCURRING:

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PHILIP G. ESPINOSA, Judge

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GARYE L. VÁSQUEZ, Judge